UNITED STATES DEPARTMENT OF AGRICULTURE
FARM CREDIT ADMINISTRATION
WASHINGTON, D. C.

SUMMARY OF CASES

RELATING TO

FARMERS' COOPERATIVE ASSOCIATIONS

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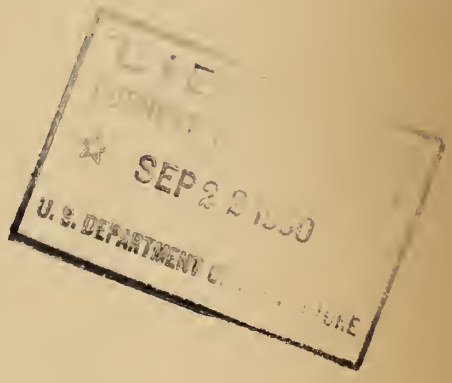

For the

COOPERATIVE RESEARCH AND SERVICE DIVISION

Summary No. 47 September 1950

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PATRONAGE REFUNDS INCREASE NET SALE PROCEEDS

The case of Houck v. Birmingham, et al., decided by the Supreme Court of Arkansas on June 12, 1950, 230 S.W. 2d 952, involved the question of whether sharecroppers who were entitled to receive one-half of the sale proceeds of cotton produced by their labor as payment for their labor were entitled to receive one-half of the patronage refunds made by a cooperative cotton gin to the landlord for whom the sharecroppers worked. The suit was brought by six sharecroppers against their landlord, R. L. Houck, and the Trial Court held that the amounts which had been paid by the landlord to each sharecropper should be increased by one-half of the patronage refunds received by the landlord on account of the cotton produced by the labor of each sharecropper. The following quotation from the opinion discloses the terms of the oral agreements under which each sharecropper worked:

> "Under the several oral crop agreements appellant was to furnish the land, equipment, tools and seed and each of the appellees was to do the work of planting, cultivating and gathering the cotton crop for which he was to receive one-half of the proceeds of the crop. As the cotton was gathered each year it was hauled to the cooperative gin by appellant, and appellees were charged $1.50 per bale in 1946 and $2 per bale in 1947 for their share of the hauling expense. There were other gins closer to the lands farmed by appellees but the original charge for ginning and price paid for cottonseed by Planters Cooperative compared favorably with that charged and paid by other gins in the community." (Underscoring added.)

Under the organization papers of the cooperative cotton gin that ginned the cotton, patronage refunds were to be paid to patrons, members and nonmembers alike, including amounts that might be carried to reserves. The bylaws specifically provided that nonmember patrons should be treated the same as members. On appeal it was argued on behalf of the landlord that there was a distinction between a tenant and a sharecropper, and in brief it was apparently his position, in view of the fact that he had title to all the cotton and that he delivered all the cotton to the cotton gin for ginning, that this operated to bar the sharecroppers from any right to any part of the patronage refunds paid by the cotton gin. The following quotation from the opinion is of interest:

> "Appellant points out the legal distinction between a tenant and a share cropper under our decisions and insists that appellees had no interest in the crop which they could control; and that their 50% share of the proceeds of the crop does not include any part of the patronage payments. We do not agree with appellant in this contention. It is true, we have held that a tenant is one who pays the landlord cash or a share of the crop, or both, for the use of the land, while a cropper is one who receives a share of the crop from his employer as payment for his labor, and is merely an employee. Barnhardt v. State, 169 Ark. 567, 275 S.W. 909. In

Hardeman v. Arthurs, 144 Ark. 289, 222 S.W. 20, 21, the court quoted with approval from Tinsley v. Craige, 54 Ark. 346, 15 S.W. 897, 16 S.W. 570, where it was said: 'Ordinarily when the parties occupy the relation of landlord and tenant, the title to the crop is in the tenant, and he pays the landlord rent in kind or otherwise; and in general where they occupy the relation of landlord and cropper on shares, the title to the crop is in the landlord, and he delivers a part of it to the cropper in payment of his services.'

"Appellees had no title to the crops until their respective one-half shares were set apart to them. Hammock v. Creekmore, 48 Ark. 264, 3 S.W. 180. Nevertheless, appellant was under a duty to divide the crops, or the proceeds thereof, with appellees. Fenton v. Price, 145 Ark. 116, 223 S.W. 364. Where a share cropper gathers the crop and turns it over to the employer-landlord to be sold, he has a cause of action against the latter for his share of the proceeds of the crop. Hemphill v. Lewis, 174 Ark. 224, 294 S.W. 1010.

"A share cropper also has a contingent interest in the crop which he may mortgage. Beard v. State, 43 Ark. 284. The Laborers Lien Statute, Ark. Stats. Sec. 51-301, has been construed to give croppers a lien on the crop grown for their labor which is superior to a mortgage on the crop given by the employer even where the mortgage is prior in point of time. Carraway v. Phipps, 191 Ark. 326, 86 S.W. 2d 12.

"The nature of the cropper's right in the crops, or the proceeds thereof, depends upon the intent of the parties as ascertained from their contract. It is undisputed that under the contractual relationship existing between appellant and appellees, the latter were entitled to receive for their services 50% of the proceeds of the crops which they produced. The question here is not one of title to crops but is whether the net proceeds of said crops include the patronage payments. If appellees had contracted for one-half the crops for their services and a division of the cotton had been made when it was gathered, and prior to ginning, appellees certainly would have been entitled to the patronage payments which are made to patrons of the gin regardless of whether they are stockholders or members of the cooperative. The mere fact that appellant hauled the cotton to the gin and made a division of the proceeds of the sale of the cotton should not work a forfeiture of appellees' right to receive their share of the patronage payments. Such payments are in reality refunds or rebates which reduce the cost of ginning to both the appellant and the appellees and thereby increase the net proceeds of the sale of the cotton." (Underscoring added.)

The Court apparently attached some significance to the fact that if the sharecroppers had received from the landlord one-half of the cotton prior to the time it was ginned, and if the sharecroppers had then delivered this cotton to the cooperative cotton gin, they would have been entitled to receive patronage refunds. Assuming this is true, it is submitted

that where the obligation of the landlord is to pay to his sharecroppers one-half of the proceeds of the crop, this should include one-half of the patronage refunds received by the landlord from the cotton gin, even though the sharecroppers might not have been entitled to receive any patronage refunds from the cooperative cotton gin if they had individually delivered cotton thereto.

Where a landlord is given the right to sell the cotton grown by sharecroppers, and it is his obligation to account to the sharecroppers for one-half of the proceeds of the crop, this would seem clearly to include any savings which he might be able to effect through advantageously having the cotton ginned at a lower cost than would otherwise be the case. If by chance the cotton had been ginned free, this would have operated to increase the net proceeds of the crop available for division.

Obviously, if the landlord had made a sale of the cotton for a price that was substantially higher than that prevailing in the community at the time of the sale, the sharecroppers would be entitled to receive any advantage accruing from the sale of the cotton at the higher price, and it would be no answer that the sharecroppers would not have disposed of the cotton at as an advantageous a price as that obtained by the landlord. In this connection the following quotation from the opinion is given:

> "The Planters Cooperative pays no income tax because of the manner of distribution of its net earnings to customers in the form of patronage payments. These payments are not dividends similar to income from ordinary stock investments, but are refunds, or rebates, due all customers of the cooperative regardless of stock ownership. The making of such payments results in a refixing and reduction of the original charge for ginning and a corresponding increase in the net proceeds derived from the sale of the cotton. The fact that the legal title to the cotton was in appellant does not lessen his obligation to pay over to appellees one-half of such net proceeds under the terms of their contract. In the absence of a stipulation in the contract to the contrary, appellees were, therefore, entitled to share equally with appellant in the patronage payments; and the chancellor correctly so held." (Underscoring added.)

It is doubted if this case is of controlling importance on the question of whether a cooperative cotton gin is eligible for exemption from the payment of Federal income taxes if landlords who are members thereof purchase the share of the crop produced by their tenants and then deliver it with the share produced by them to cooperative cotton gins and receive and retain all the patronage refunds paid thereon. (See Summary No. 35, page 11, and Summary No. 42, page 13.)

Attention is called to the fact that the Supreme Court of Arkansas specifically held that a landlord in Arkansas in the case of sharecroppers had title to all the cotton produced on his farm. This would seem to mean that where a landlord delivers all such cotton to a cotton gin and

is simply under an obligation to account to his sharecroppers for one-half of the proceeds of the crop, the sharecroppers have no title to any part of the crop because no part of the cotton was turned over to them. The landlord under these circumstances is not engaged in the buying of any cotton from anybody. He is simply obligated to account to his sharecroppers for one-half of the proceeds of the crop. In brief, a sharecropper under Arkansas law is "merely an employee," and the title to the cotton which he helps to grow is in the landlord unless and until a share thereof is turned over to a sharecropper. In other words the landlord is the producer of all cotton raised, and if he is authorized to market all the cotton without turning over any part thereof to his sharecropper, the sharecropper entitled to a share of the sale proceeds is entitled to have the sale proceeds increased by the amount of the patronage refunds. Such refunds are simply a reduction in marketing costs.

INCOME TAXES - BUSINESS DONE FOR THE UNITED STATES

The last sentence in paragraph 12 of section 101 of the Internal Revenue Code, which paragraph provides for the exemption of agricultural cooperative associations that meet its conditions, reads as follows:

> "Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph." (Underscoring added.)

On July 18, 1950, a cooperative association telegraphed the Bureau of Internal Revenue as follows:

> "We have been contacted by QM Corps of the U.S. Army to assemble, pack and ship a possible minimum of 2,000,000 cases of rations. These cases to require 57 different items of which we shall furnish two or three out of our own production - they to furnish remainder.
>
> "We are being pushed for commitment and feel it our duty to comply but do not want to endanger our present exempt status. If we pro rate revenues from this operation to member and non member producers will we maintain exemption. Quick answer imperative, please wire collect."

To this telegram the Bureau of Internal Revenue replied as follows:

> "Reference telegram eighteenth status for Federal income tax purposes will not be affected by proposed transaction with Quartermaster Corps US Army since under law business done for United States or any of its agencies shall be disregarded in determining right to exemption."

Attention is called to the fact that the business in question that is to be disregarded is business done for the United States or any of its agencies.

MEMBERS OF NONSTOCK ASSOCIATION NOT COMMON STOCKHOLDERS

In the case of Warren Rural Electric Cooperative Corporation, Inc., et al., v. Harrison, et al., decided by the Court of Appeals of Kentucky, 229 S.W. 2d 473, the question for decision was whether section 279.130 of the Kentucky Revised Statutes, a part of the Rural Electric Cooperative Act of that State, which provides that "The obligations (of the Cooperative) shall be authorized by resolution of the board of directors, after a resolution is first passed by a majority of the common stockholders giving the board that power," applied to a nonstock electric cooperative association incorporated under that Act.

The Court, after examining the Rural Electric Cooperative Act of Kentucky concluded that the statutory provision quoted above had no application to a nonstock cooperative association incorporated under that Act, and that an obligation of the nonstock electric cooperative was sufficient when authorized by a majority of a quorum of the members, although less than a majority of all the members.

In many of the agricultural cooperative association acts, the term "member" is defined so as to include common stockholders, in associations formed with common stock, and the members of nonstock associations. In any instance, however, in which the term "common stockholder" is used without language giving it a broader meaning than that which the term ordinarily implies, it is believed that the term "common stockholder" normally does not include a member of a nonstock association.

LIABILITY OF OFFICERS OF CORPORATIONS

In the opinion of the Court in the case of Hirsch v. Phily, decided by the Supreme Court of New Jersey, 73 A. 2d 173, the following appears:

> "It is well settled by the great weight of authority in this country that the officers of a corporation are personally liable to one whose money or property has been misappropriated or converted by them to the uses of the corporation, although they derived no personal benefit therefrom and acted merely as agents of the corporation. The underlying reason for this rule is that an officer should not be permitted to escape the consequences of his individual wrongdoing by saying that he acted on behalf of a corporation in which he was interested. 152 A.L.R. 703; 3 Fletcher on Corporations, §§ 1140-1142. In Rose v. Bernhardt, 107 N.J.L. 501, 504, 153 A. 609, 610 (E. & A. 1931), under a factual situation analogous to that here presented, the court stated: 'Where there is a fraudulent and unlawful conversion by the corporation, then those who participate therein by instigation, aid, or assistance are liable. * * * The mere fact that Bernhardt was acting as the president of the corporation and Weisberg was acting as its treasurer, and that they individually did not receive any of this

money, is immaterial since there was evidence to justify the jury in concluding there was an unlawful and fraudulent conversion by the corporation which was directed by them. Reliable Woodworking Co. v. Lindeman, 105 N.J.L. 121, 143 A. 333.'" (Underscoring added.)

It will be remembered that the foregoing statement is as applicable to the officers of cooperative corporations as it is to the officers of noncooperative corporations. Members and creditors of cooperative corporations may undoubtedly hold the officers and directors of such corporations liable for losses or injuries which they have suffered because of illegal acts violating their rights by the officers or directors concerned.

DERIVATIVE ACTION - COOPERATIVE ASSOCIATION

In the case of Noble v. Farmers Union Trading Company, decided by the Supreme Court of Montana, 216 P. 2d 925, it appeared that the plaintiff owned one share of stock in the Farmers Union Trading Company, a cooperative corporation. He filed a suit in equity to quiet title to certain town lots in Sheridan, Montana, of which he averred the corporation "is the sole and exclusive owner in fee simple title." He named the corporation and one Charles Wiggins as defendants. He filed the suit because the cooperative corporation was paying Wiggins "$70 per month as alleged rental for the use and occupancy of part of such real property."

The position of Noble was that the corporation was proceeding illegally in paying Wiggins any rental, because the plaintiff claimed that the cooperative corporation was the sole owner of the property involved. The plaintiff, by the suit which he instituted, attempted to have the Court hold that any claims to rental by Wiggins were void. The plaintiff asserted that before beginning the action he had demanded that the directors and officers of the corporation "'take the necessary proceedings in court to quiet the title * * * as against all claims, alleged claims and pretentions' of the defendant Wiggins," and that the board of directors had failed and refused to institute such a proceeding.

The complaint of the plaintiff was dismissed on demurrer, and on appeal the judgment of the trial Court was affirmed.

The only question that was passed upon by the Court was the right of the plaintiff to institute and maintain an action of the character in question.

The Court in passing upon the question of whether the plaintiff could maintain the action analyzed the nature and character of a corporation. In doing so, the Court said in part:

"A corporation is not a person. In re Clarke's Will, 204 Minn. 574, 284 N.W. 876. It is merely a legal fiction created for convenience in conducting business. Whipple v. Industrial Commission,

59 Ariz. 1, 121 P. 2d 876, 878. It can be created only by or under legislative authority. 1 Fletcher Cyc., Corporations (Perm. Ed.), sec. 15, pp. 36, 37, note 65. Being a mere creature of law established for special purposes a corporation receives all its powers from the Act creating it. People ex rel. Cairo & St. L. R. Co. v. Dupuyt, 71 Ill. 651, 655. It acts through its board of directors and officers (R.C.M. 1947, sec. 14-206 and sec. 15-401) and its property is not subject to the control or disposition of its members or stockholders. Sellers v. Greer, 172 Ill. 549, 50 N.E. 246, 248, 40 L.R.A. 589. Compare: North Hudson County R. Co. v. May, 48 N.J.L. 401, 19 Vroom 401, 5 A. 276; Judd v. City Trust & Savings Bank, 133 Ohio St. 81, 12 N.E. 2d 288; Stokes v. Continental Trust Co., 186 N.Y. 285, 78 N.E. 1090, 1093, 12 L.R.A., N.S., 969, 9 Ann. Cas. 738; Frank Gilbert Paper Co. v. Prankard, 204 App. Div. 83, 198 N.Y.S. 25, 27.

* * * * * * *

"A corporation may lease from third persons property for the use of the corporation and its directors were prima facie empowered to lease an office at the place designated in its charter or articles of incorporation for the principal office of the corporation. McConnell v. Combination Min. & Mill. Co., 31 Mont. 563, 573, 79 P. 248. Likewise the directors may lease a part of the corporate property without first obtaining the consent of the stockholders. Seal of Gold Min. Co. v. Slater, 161 Cal. 621, 120 P. 15. 'Corporate authority to take a lease of property need not necessarily rest upon an express grant of power. In this respect it is no different from other acts and transactions of the corporation. If the taking of a particular lease is within the purposes of the corporation and not foreign to the business for which it was created, it may be justified as an exercise of the implied powers of the corporation. Corporations organized to carry on a * * trading business necessarily have power to take a lease of property when necessary to the conduct of such business.' 7 Fletcher Cyc., Corporations (Perm. Ed.), sec. 2977, p. 22. Compare Polacheck v. Michiwaukee Golf Club, 198 Wis. 78, 223 N.W. 233; Thauer v. Gaebler, 202 Wis. 296, 232 N.W. 561, 563."

The Court in passing upon the status of stockholders of a corporation said:

"The functions of stockholders are exceedingly limited. Every stockholder impliedly agrees, on becoming a member of the corporation, to the execution of all the powers conferred by law on the corporation. He consents that the management and control of the corporate business and interests shall be vested in the board of directors and agrees that such board shall exercise the corporate powers vested in the corporation. He knows that ordinarily, as a stockholder, he must abide by the decision of the directors or the stockholders in their aggregate capacity, as the case may be, upon all matters which the law commits to their control and determination.

He is charged with the knowledge that generally, in the absence of statutory authority, the stockholders cannot act for the corporation either individually or collectively; that by reason of being a stockholder he has no agency for the corporation; that he cannot bind it; and that direct participation in the management of corporate affairs is not a right which the stockholders, as such, can claim. 18 C.J.S., Corporations, § 495, pages 1171, 1172, and R.C.M. 1947, sec. 14-206. 'He has no direct control over the money and property of the corporation, the right to control and manage the corporate property being vested in the corporation and exercisable through the directors, officers, and agents.' 18 C.J.S., Corporations, § 512, page 1191, note 45. However, a stockholder dissatisfied with the internal management of a corporation has a right to call his fellow stockholders' attention to conditions which he, in good faith, regards as prejudicial to the best interests of the corporation and its stockholders. Grayburg Oil Co. v. Jarratt, Tex. Civ. App., 16 S.W. 2d 319. Compare: First Nat. Bank of Waterloo v. Fireproof Storage Bldg. Co. 199 Iowa 1285, 202 N.W. 14, 17; Mt. Vernon Bank & Trust Co. v. Iowa Employment Security Comm., 233 Iowa 1165, 11 N.W. 2d 402, 403. 'The board of directors, acting in the manner prescribed by law, and not the stockholders of a corporation, conducts and controls the business and property of the corporation (sec. 5933, Rev. Codes 1921 [R.C.M. 1947, sec. 15-401]; Raish v. Orchard Canal Co., 67 Mont. 140, 218 P. 655); the payment of approved claims is but an incident to the conducting of the business in which the corporation is engaged.' Pioneer Minerals Corp. v. Larabie Bros. Bankers, 99 Mont. 358, 43 P. 2d 884, 886. See also: Hanrahan v. Anderson, 108 Mont. 218, 231, 90 P. 2d 494."

Statements in the majority opinion indicate that the averments in the complaint of the plaintiff did not definitely state that there was no legal basis for the cooperative corporation's leasing the property in question. In this connection, the Court said:

"The averment that the defendant Wiggins 'has demanded and received from said cooperative association the sum of $70.00 per month as alleged rental for the use and occupancy of part of the real property' of which the corporation is alleged to be 'the sole and exclusive owner in fee simple title' does not of itself show that the alleged act of leasing is either ultra vires, illegal or fraudulent. One may be the sole owner of the fee to the real estate and not own the store building situate thereon, nor have the right to the use or possession of such building. One may be owner of the fee and yet not be entitled to 'the use and occupancy of part of the real property.' An owner of the fee may enter into a lease of his property for one, 10 or 40 years and thereby surrender his right to 'the use and occupancy' of the property in part or in whole. The owner of the fee of a hotel property which he has leased to another may still be required to pay a rental to entitle him to 'the use and occupancy' of a room or of office space therein." (Underscoring added.)

That the Court was of the opinion that the complaint of the plaintiff was insufficient is shown by the following quotation:

> "In the instant case the complaint does not allege that plaintiff requested the directors to call a special meeting of stockholders or the provisions in the by-laws governing special meetings or that the directors controlled a majority of the stock or that plaintiff had procured a list of the stockholders, or that he had contacted or attempted to contact them, or that he had been denied the right to inspect the corporation's books to obtain the names and addresses of the stockholders, nor did plaintiff allege any ultra vires act, fraud or bad faith on the part of the corporation's directors, or on the part of the defendant Wiggins. Such complaint was and is clearly insufficient under the repeated decisions of this court, including the Mountain case, supra." (Underscoring added.)

This case brings out the fact that normally the board of directors of a corporation, cooperative or otherwise, is vested with discretion to determine if a suit or other action for and on behalf of the corporation should be taken. Normally, it is a matter for the determination of the board of directors and not of the stockholders whether a suit will be instituted in a given situation.

On the other hand, if the directors are acting ultra vires or are guilty of fraud or bad faith, it then is clearly established that one or more stockholders may bring a suit to protect the interests of the corporation. (See Hawes v. Oakland, 104 U.S. 450, 26 L. Ed. 827.)

Again, it is clearly established that in any instance in which the directors and officers of a corporation, cooperative or otherwise, are acting ultra vires or are violating the terms of contracts entered into with its members that any member may bring a suit for the purpose of enjoining the directors and officers from acting illegally. (See McCauley v. Arkansas Rice Growers' Co-op. Ass'n, 171 Ark. 1155, 287 S.W. 419; Galloway v. Mitchell County Electric Membership Corporation, 190 Ga. 428, 9 S.E. 2d 903, and "Legal Phases of Cooperative Associations," p. 69.)

FRANCHISE TAXES - COOPERATIVE ASSOCIATION

The case of Central Ohio Cooperative Milk Producers v. Glander, 92 N.E. 2d 834, decided by the Board of Tax Appeals of Ohio, involved the question of whether the agricultural cooperative association was required to pay franchise taxes, and if so, the basis on which the amount of such franchise taxes should be computed. The Tax Commissioner of the State of Ohio held that the association was liable for franchise taxes, and the association appealed. The basis for the appeal is set forth in two paragraphs of the association's notice of appeal, which paragraphs read as follows:

> "(1) 'The provisions of section 5495 et seq., of the General Code insofar as it is intended to include corporations not for profit

thereunder for franchise tax purposes are discriminatory, unconstitutional and void and Appellant is not liable for said tax.

"(2) 'The true value of the stock of the Appellant, were it subject to said franchise tax, has been incorrectly determined by an inclusion therein of the following:

'(a) $14,927.97 Bad Debt Cont.
'(b) $18,050.45 Undistributed refunds for prior years.'"

At the time the association was incorporated, there was a provision in the Agricultural Cooperative Marketing Act of Ohio reading as follows:

"'Each association organized hereunder shall pay into the state treasury an annual fee of ten ($10) dollars only, in lieu of all franchise or license or corporation or taxes or charges upon reserves held by it for members.'"

Following its incorporation, however, the Legislature of Ohio repealed the section quoted. The Cooperative Act of Ohio contains a section reading as follows:

"'The provisions of the general corporation laws of this state and all powers and rights thereunder, shall apply to the association organized hereunder, except where such provisions are in conflict with or inconsistent with the express provisions of this act.'"

In this connection, the Board of Tax Appeals said that when the Legislature repealed the section quoted above providing for an annual fee of $10 "in lieu of all franchise or license or corporation or taxes or charges upon reserves held by it for members," the association became amenable to the general corporation laws, meaning apparently with respect to taxation.

The applicable sections of the statutes of Ohio relative to franchise taxes read as follows:

"G.C. Section 5498: '* * * For the purpose of this act, (Excise and Franchise Taxes on Corporations--5485 et seq.) the value of the issued and outstanding shares of stock of any such corporation shall be deemed to be the total value, as shown by the books of the company of its capital, surplus, whether earned or unearned, undivided profits, and reserves, but exclusive of (a) proper and reasonable reserves for depreciation, and depletion as determined by the tax commission (tax commissioner), (b) taxes due and payable during the year for which such report was made, (c) the item of good will as set up in the annual report of the corporation when said annual report is accompanied by certified balance sheet showing such item of good will carried as an asset on the books of the company, * * * (d) such further amount as upon satisfactory proof furnished by the corporation, the tax commission may find to represent the amount, if any, by which the value of the assets (other than good will) of the corporation as carried on its books exceeds the fair value thereof. * * *' (Underscoring added.)

"G.C. Section 5498-1: 'The phrase "issued and outstanding shares of stock" as used in section 5498 of the General Code shall apply to corporations not for profit and shall include but shall not be limited to mean membership certificates and other instruments evidencing ownership of an interest in such corperations not for profit.'

"G.C. Section 5495-2: 'Annually, * * *, each corporation, incorporated under the laws of this state for profit and each corporation not for profit organized under sections 10185 and 10186 of the General Code and sections 10186-1 and 10186-30, both inclusive, of the General Code * * *, shall make a report in writing to the tax commissioner in such form as the commissioner may prescribe. * * *.'"

In disposing of the point raised by the association that construing the statutes of Ohio relative to franchise taxes so as to make them apply to cooperative associations was discriminatory and unconstitutional, the Board of Tax Appeals said:

"It will be noted that the effective date of this section, 5495-2, September 4, 1947, is the same as that of the repeal of G.C. Section 10186-29 hereinbefore set forth. A review of these statutes clearly indicates that cooperative associations are now subject to the payment of franchise taxes just the same as all general corporations. It is the judgment of the Board of Tax Appeals that appellant has not been discriminated against and that the Tax Commissioner was fully empowered by statute to assess the tax payer for franchise taxes in accordance with general law. It is the observation of the Board, but not its holding, that it is unable to conceive of the unconstitutionality of the statutes questioned from any viewpoint." (Underscoring added.)

As shown by the notice of appeal of the association, the Tax Commissioner of Ohio had included $14,927.97, which was carried on the books of the association under the heading "Bad Debt Contingency," and had also included the amount of $18,050.45, which was carried on the books of the association under the heading "Undistributed Refunds for Prior Years," in determining the amount of the franchise taxes to be paid by the cooperative association. It appears that the reserve of $14,927.97 was an amount which was accumulated by the association for the purpose of insuring that the members of the association would always be paid for the milk which they sold through the association. The Board of Tax Appeals held that the Tax Commissioner had not erred in including this amount in the sum on which franchise taxes were to be computed, and in this connection called attention to the discretion vested in the Tax Commissioner by subsection (d) of G.C. Section 5498, which is quoted above.

The Board of Tax Appeals in holding that the Tax Commissioner had not erred in including in the amount on which franchise taxes were to be

computed the amount of $18,050.45, which represented undistributed refunds for prior years, said:

"Was appellant aggrieved by the Tax Commissioner's order refusing to allow the $18,050.45 (undistributed refunds for prior years) as a deduction from its book value in arriving at its fair value? The Commissioner did allow it current undivided refunds of $3,504.91. Appellee found, as the evidence discloses, that the association, through any corporate action, never made any effort to repay these sums to the producers entitled to their just portion thereof, many of whom are now dead or otherwise retired therefrom as members. It also appears that this sum is mixed with other sums and used just the same as its capital assets were used. It is not shown or treated as a trust fund as now claimed. Out of each hundredweight of milk sold by a producer, 4¢ of the price paid the producer went into appellant's treasury. Two and a half cents thereof was retained by it for operating expenses. As stated by a company officer, 'we' have apparently deducted from the producer's checks more for expenses than was actually needed, and this excess makes up the patronage fund which has been accumulating over a period of about eight years.

"G.C. Section 10186-13 provides in part that: '* * * The association shall limit its dividends on stock to any amount not greater than eight (8) per cent per annum; and all other net income, less specified reserves which shall be provided for in the by-laws, shall be distributed back to its members only on the basis of patronage. * * *.'

"It will be noted that this section does not provide when distribution on the basis of patronage shall be made. Neither is any time specified in the Association's by-laws. No corporate action has been taken to that end. G.C. Section 10186 authorizes such an association to adopt a plan for distribution. It further states that '* * * profits arising from the business may be divided among the stockholders from time to time, as it deems expedient, in proportion to the several amounts of their respective purchases.' Here again the time element is left in abeyance. There can be no question that this sum of $18,050.45 represents corporate income from prior years. It is just as true that it also represents undivided profits to be distributed to producer stockholders according to patronage. G.C. Section 5498 specifically directs that 'undivided profits' shall be included in ascertaining the value of shares of stock of any corporation.

* * * * * * *

"It is the Board's judgment that this is the course pursued by appellant's Board of Directors. By retention of patronage refunds beyond what might be considered a reasonable time without objection by stockholder producers, it has temporarily, at least, increased its capital structure. Appellant ought not to complain of that

which its course of inaction deliberately brought about. Finding no error in the order complained of, the same is in all respects affirmed." (Underscoring added.)

Attention is called to the fact that the amounts on which franchise taxes were computed were amounts that were used in the general business of the cooperative.

FAIR LABOR STANDARDS ACT - COOPERATIVE MARKETING ASSOCIATION

In the case of Puerto Rico Tobacco Marketing Cooperative Association v. McComb, 181 F. 2d 697, it appeared that the Administrator of the Wage and Hour Division of the United States Department of Labor brought an action against the Puerto Rico Tobacco Marketing Cooperative Association to restrain it from violating certain sections of the Fair Labor Standards Act of 1938, 52 Stat. 1068, 29 U.S.C.A. § 215 (a) (1), (2), (5).

Agricultural labor is specifically exempt from the terms of the Fair Labor Standards Act. The cooperative association, which handled only tobacco grown by its members, unsuccessfully contended that it was exempt from the Fair Labor Standards Act because its employees were employed in agriculture. The argument of the cooperative association appears to have been that the members of this association were simply doing collectively what each of them could have done individually, and that therefore the operations of the association were simply an extension of the agricultural activities of the various members of the association. The Court in answering this argument said:

"The defendant's contention that its employees fall within the exemption of § 13(a) (6) because they are 'employed in agriculture' as that term is defined in § 3(f) must be categorically rejected on the authority of Farmers Reservoir & Irrigation Co. v. McComb, 337 U.S. 755, 69 S. Ct. 1274, in which the Supreme Court rejected the same contention with respect to the employees of an incorporated mutual ditch company organized on a non-profit basis by a group of farmers in Colorado for the purpose of collecting, storing, and proportionately distributing water to its farmer-members for irrigation purposes. In its opinion in the above cited case the court pointed out, 337 U.S. at page 762 et seq., 69 S. Ct. at page 1278, that the definition of agriculture in § 3(f) had two branches--first a 'primary meaning' which includes 'farming in all its branches'; specific farming practices, such as cultivation and tillage of the soil, dairying, etc. being listed as illustrative, and a secondary broader meaning which includes 'any practices, whether or not themselves farming practices, which are performed either by a farmer or on a farm, incidentally to or in conjunction with' farming operations within the primary definition. Then the court said that clearly the operations of the irrigation company, and we must say the same with respect to the operations of the defendant marketing company, did not fall within the primary meaning of agriculture as defined in the

above section of the Act for the reason that it owned no farms and raised no crops, and hence could not be said, 337 U.S. at page 764, 69 S. Ct. at page 1279, to be 'engaged in cultivating or tilling the soil or in growing any agricultural commodity.' Following this the Supreme Court rejected the contention, not advanced in the case at bar, that the employees of the irrigation company come within the exemption because its activities were necessary to the production of agricultural commodities, and then, coming to the secondary branch of the definition, the court pointed out that to qualify for exemption the work must be done 'by a farmer or on a farm.' It then said, and we must say also: 'In the present case it is clear that the work of the company's employees is done neither on a farm or by farmers.'"

The manner in which the tobacco was handled by the association and the type of work done by employees of the cooperative association is shown in the following quotations from the opinion:

"The members first dry their tobacco in barns or sheds on their premises and then deliver it at the Association's warehouses in loose bales or bundles weighing about one quintal, or one hundred pounds. There it is first weighed and receipted for and then graded according to type and quality. Following this the tobacco is put into piles known locally as 'estibas' of about 150 quintales and allowed to ferment under controlled conditions of temperature for about two months, during which time the piles are torn down and rebuilt by moving the inside leaves to the outside of the pile, and vice versa, some six or eight times as the fermentation process requires. When this fermentation process, known as bulking, is completed the tobacco is stacked for later stemming.

"When the stemming season starts the fermented tobacco is reclassified into tobacco of inferior quality, known as 'boliche', and tobacco of superior quality. The 'boliche' is not stemmed, but merely fumigated and packed for shipment. The tobacco of superior quality which is to be stemmed is first dipped in water to soften it for the purpose, and then the moistened leaves are left in piles for several days. After this the piles are separated into packages called 'pesadas' weighing 5 or 6 pounds and these 'pesadas' are wrapped in cloth and taken to a steaming room from which they are later removed for delivery to the stemmers."

The cooperative association made the argument "that its employees are working in an area of production as defined by the Administrator, which he admits, and that they are engaged in handling and preparing for market an agricultural or horticultural commodity, which the Administrator concedes, in its raw or natural state, which the Administrator denies." (Underscoring added.) In other words, it was the contention of the cooperative association that its employees were exempt from the Fair Labor Standards Act because the employees worked on the tobacco "in its raw or natural state." The Court, however, held that in view of the changes that were effected in the tobacco by the way in which it was

handled and conditioned by the association that the employees did not work on the tobacco in its raw or natural state. In this connection the Court said in part:

> "In this case we agree with the line of distinction with respect to leaf tobacco drawn by the court below. Perhaps within the statutory wording it might possibly be drawn a step earlier in the processing, i.e., at the first fermenting, rather than at stemming, but the Administrator's concession that workers engaged in processing prior to stemming are exempt makes it unnecessary for us to consider the point. Whether leaf tobacco comes from the first fermentation process 'raw' or not, a very close question perhaps, the leaf certainly was not in its natural state after its central vein or rib was removed. This changed its form. The process is comparable to grinding a cereal grain, for instance, and we think clearly marked the line between exempt and nonexempt work. Our judgment is perhaps arbitrary in the sense that the line could conceivably be drawn somewhere else without doing violence to the statutory language, but in cases of this sort arbitrary judgments in this limited sense cannot wholly be avoided. The best that can be done is to draw a line of distinction with respect to each commodity at some practical point within the statutory language, and this in our opinion is exactly what was done by the court below. We, therefore, agree with the conclusion it reached."

PERISHABLE AGRICULTURAL COMMODITIES ACT

In California Fruit Exchange v. Henry, 89 F. Supp. 580, it appeared that the California Fruit Exchange sold two carloads of Emperor grapes to the defendants f.o.b. shipping point. Upon arrival the defendants rejected each carload. The Exchange then sold the grapes and instituted proceedings under the Perishable Agricultural Commodities Act, which resulted in the Secretary of Agriculture making a reparation award in favor of the Exchange in the amount of $2,119.40 with interest. The Exchange then brought suit and the jury rendered a verdict in favor of the Exchange for $1.00 against the defendants.

A number of contentions were made by the defendants, among them, the contention that the Exchange had failed to ship the type and quality of merchandise required by the terms of the contract, that the grapes had a latent defect, that the grapes when delivered contained a gray mold rot condition which was of field origin, and it was also apparently contended by the defendants that the Exchange had not used due care in selling the grapes after they had been rejected by the defendants. The Exchange claimed its evidence that it had used due care in the selling of the grapes was uncontradicted, and this seems to have been admitted, but the Court called attention to the fact that the witness had an interest in testifying as he did, and that therefore "the believability of the witness' testimony remains a question of fact for the jury."

This case sheds considerable light on proceedings to enforce reparation awards made under the Perishable Agricultural Commodities Act by the Secretary of Agriculture.

The following quotations from the opinion should be of interest:

"The purpose of the P.A.C.A. was primarily to eliminate unfair practices in the marketing of perishable agricultural commodities in interstate commerce in the case of a declining market by making it difficult for unscrupulous persons to take advantage of shippers by wrongful rejection of the goods upon arrival at a point where it is expensive and impractical for the shipper to enforce his legal rights. To effectuate this purpose, Congress did not go so far as to make rejection by buyers unlawful altogether. Instead, it made rejection of shipments of perishable agricultural commodities by buyers unlawful 'without reasonable cause.' LeRoy Dyal Co. v. Allen, supra; Joseph Martinelli & Co. v. Simon Siegel Co., 1 Cir., 176 F. 2d 98.

"A prima facie case made out by the findings of the Secretary of Agriculture must prevail in this court unless overcome by evidence submitted by Spracale, notwithstanding the proceeding in this court is not in the nature of an appeal from, or review of determination, but is a proceeding de novo. Barker Miller Distributing Co. v. Berman, D.C., 8 F. Supp. 60; Alexander Marketing Co. v. Harrisburg Daily Market, D.C., 87 F. Supp. 124." (Underscoring added.)

* * * * * * *

"Where food products do not meet the contract requirements, the shipper must bear the loss resulting from deterioration in transit and the fact that the defect in the commodity is not discernible at the point of shipment does not alter the liability which falls upon the shipper by reason of the implied warranty which is attached to the goods. However, since title and risk pass to the buyer at the point of shipment under a sale, such as existed in this case, f. o. b. shipping point, if the goods met the contract requirements at the point of shipment, any normal deterioration losses which arose in transit would fall upon the buyer. A. J. Conroy, Inc. v. Weyl-Zuckerman & Co., supra; Steel City Fruit Co. v. Monheim's Wholesale Produce Co., D. C., 64 F. Supp. 275." (Underscoring added.)